

NOTICES OF PROPOSED RULEMAKING Initiated After January 1, 1995

Unless exempted by A.R.S. § 41-1005, each agency shall begin the rulemaking process by first filing a Notice of Proposed Rulemaking, containing the preamble and the full text of the rules, with the Secretary of State's Office. The Secretary of State shall publish the notice along with the Preamble and the full text in the next available issue of the *Arizona Administrative Register*.

Under the Administrative Procedure Act (A.R.S. § 41-1001 *et seq.*), an agency must allow at least 30 days to elapse after the publication of the Notice of Proposed Rulemaking in the *Register* before beginning any proceedings for adoption, amendment, or repeal of any rule. A.R.S. §§ 41-1013 and 41-1022.

NOTICE OF PROPOSED RULEMAKING

TITLE 9. HEALTH SERVICES

CHAPTER 2. DEPARTMENT OF HEALTH SERVICES TOBACCO TAX-FUNDED PROGRAMS

PREAMBLE

1. **Sections Affected**
Article 1
R9-2-101.
- Rulemaking Action**
New Article
New Section
2. **The specific authority for the rulemaking, including both the authorizing statute (general) and the statutes the rules are implementing (specific):**
Authorizing statutes: A.R.S. §§ 36-104(3) and 36-136(F)
Implementing statute: A.R.S. § 36-2907.06(D)
3. **The name and address of agency personnel with whom persons may communicate regarding the rule:**
Name: Phil Lopes
Address: Department of Health Services
1740 West Adams, Suite 312
Phoenix, Arizona 85007
Telephone: (602) 542-1216
Fax: (602) 542-1244
4. **An explanation of the rule, including the agency's reason for initiating the rule:**
These rules are necessary to approve a sliding discount fee schedule. The sliding fee schedule is mandated by statute as a prerequisite for participation in the tobacco tax primary care program.
5. **A showing of good cause why the rule is necessary to promote a statewide interest if the rule will diminish a previous grant of authority of a political subdivision of this state:**
Not applicable.
6. **The preliminary summary of the economic, small business, and consumer impact:**
The economic impact on small business and consumers of submitting a sliding discount fee schedule to the Department for approval will be negligible. The sliding fee scale is a prerequisite for participation in the tobacco tax primary care program. It is this program that will have an impact on business and consumers.
The impact on small businesses will be considerable. In addition to filing a sliding fee schedule for approval, other reports will be required by contract in order to participate in the tobacco tax primary care program. These reports may require facilities/individuals to purchase computer hardware and software or modify existing systems. Due to the variable capabilities of different providers, it is impossible to give an average but could easily exceed \$30,000 on a statewide basis. Most of these costs may be offset by the tobacco tax primary care program being authorized to contract for up to \$5,000,000 initially for the delivery of primary care services to an expanded number of residents of the state. Additionally, involvement in the tobacco tax primary care program is voluntary and these reporting requirements will only apply to those facilities/individuals who choose to participate.
The consumers in the tobacco tax primary care program are Arizona residents who have an income of less than 200% of the poverty level as established by the United States Department of Health and Human Services and are uninsured. The impact to these consumers is expected to be considerable also. The cost of an individual obtaining health care from a primary care provider should remain at current levels. The major impact on consumers will appear in the anticipated expansion of availability of primary care services and therefore diagnosing illnesses at an early stage when diseases or illnesses are more easy and less costly to treat. The financial impact is impossible to measure. The financial impact on a family where an individual may be treated prior to an illness becoming debilitating

Arizona Administrative Register
Notices of Proposed Rulemaking

or fatal is impossible to measure as well as there being no adequate way to measure the financial benefits on the increased quality of life.

This program and related requirements are not expected to have an economic impact on any other governmental agencies.

7. The name and address of agency personnel with whom persons may communicate regarding the accuracy of the economic, small business, and consumer impact statement:

Name: Phil Lopes
Address: Department of Health Services
1740 West Adams, Suite 312
Phoenix, Arizona 85007
Telephone: (602) 542-1216
Fax: (602) 542-1244

8. The time, place, and nature of the proceedings for the adoption, amendment, or repeal of the rule or, if no proceeding is scheduled, where, when, and how persons may request an oral proceeding on the proposed rule:

Date: September 11, 1995
Time: 8:30 a.m.
Location: North Building, Suite 222
400 West Congress
Tucson, Arizona 85701
Nature: Conduct hearing on proposed rules

Date: September 11, 1995
Time: 2 p.m.
Location: Department of Health Services
1740 West Adams, Room 309
Phoenix, Arizona 85007
Nature: Conduct hearing on proposed rules

Written comments may be submitted to the individual designated in #7.

9. Any other matters prescribed by statute that are applicable to the specific agency or to any specific rule or class of rules:

Not applicable.

10. Incorporation by reference and their location in the rules:

Not applicable.

11. The full text of the rules follows:

TITLE 9. HEALTH SERVICES

**CHAPTER 2. DEPARTMENT OF HEALTH SERVICES
TOBACCO TAX-FUNDED PROGRAMS**

ARTICLE 1. SLIDING SCHEDULE OF FEES

R9-2-101. Approval of Sliding Discount to Fee Schedule

ARTICLE 1. SLIDING SCHEDULE OF FEES

R9-2-101. Approval of Sliding Discount to Fee Schedule

A. An application for approval of a sliding discount to fee schedule shall be submitted at least 30 days prior to implementation and shall include a cover sheet with the following:

- 1. Name of facility.**
- 2. Street address.**
- 3. City.**
- 4. State.**
- 5. Zip code.**
- 6. Phone number.**
- 7. Name of officer or administrator of facility, and**

8. Name of preparer.

B. The sliding discount to fee schedule shall encompass income levels from 100% to at least 200% of the federal poverty level as established by the United States Department of Health and Human Services. The sliding discount to fee schedule shall indicate that for those individuals with incomes between 0 and 100% of the poverty level:

- 1. The sliding discount fee shall be zero, and**
- 2. Administrative fees shall be zero.**

C. The financial liability of a patient or client shall not exceed the sliding discount fee schedule when applied to the lowest contracted amount for services that the applicant has in force at the time services are rendered.

D. For purposes of this Section, "sliding discount fee schedule" is defined as a document which establishes a relationship between an individual's income and family size with the percentage of the charges for services for which the individual will be responsible.

NOTICE OF PROPOSED RULEMAKING

TITLE 14. PUBLIC SERVICE CORPORATIONS; CORPORATIONS AND ASSOCIATIONS; SECURITIES REGULATION

CHAPTER 4. CORPORATION COMMISSION SECURITIES

PREAMBLE

1. Sections Affected

R14-4-117
R14-4-301
R14-4-302
R14-4-303
R14-4-304
R14-4-305
R14-4-306
R14-4-307
R14-4-308

Rulemaking Action

Repeal
Amend
Amend
Amend
Amend
Amend
Amend
Amend
Amend

2. The specific authority for the rulemaking, including both the authorizing statute (general) and the statutes the rules are implementing (specific):

Authorizing statutes: A.R.S. §§ 44-1821 and 44-3131

Implementing statutes: A.R.S. §§ 44-1822, 44-1823, 44-1971, 44-1972, 44-1973, 44-2032, 44-2036, 44-3211, 44-3212, 44-3213, 44-3292, and 44-3296

Constitutional authority: Arizona Constitution Article 15, §§ 4, 6, and 13

3. The name and address of agency personnel with whom persons may communicate regarding the rulemaking:

Name: Richard Weinroth, General Counsel
Address: Arizona Corporation Commission, Securities Division
1300 West Washington, Third Floor
Phoenix, Arizona 85007
Phone: (602) 542-4242
Fax: (602) 542-3583

4. An explanation of the rule, including the agency's reasons for initiating the rule:

The Commission is proposing the amendment of R14-4-301 through R14-4-308 (the "Enforcement rules") and the repeal of R14-4-117. The Commission is proposing the amendments to the Enforcement rules to extend their scope to include enforcement actions brought pursuant to the Arizona Investment Management Act, A.R.S. § 44-3101 *et seq.*, (the "IM Act"). The amendments, in conjunction with the proposed Investment Adviser rules (R14-6-101 through R14-6-209) will provide a comprehensive system of regulation for investment advisers and their representatives in Arizona. Further, the amendments to the Enforcement rules will aid in the prosecution of securities and investment-adviser fraud in Arizona and produce more efficient administrative proceedings. Some of these changes include: the provision for methods of service of subpoenas, notices, and orders in foreign countries; modification of provisions relating to service completion; providing when service of process on a respondent's attorney will be valid service on the respondent; and making it an administrative rule violation for a witness to knowingly make a material misstatement or omission during a formal interview. The Commission also is proposing the repeal of R14-4-117. The substance of this rule has been added to amended R14-4-303, rendering R14-4-117 obsolete. The proposed amendments are as follows:

R14-4-301. Scope of Article: provides that the Enforcement rules apply to examinations and investigations conducted under either the Arizona Securities Act, A.R.S. § 44-1801 *et seq.* (the "Securities Act"), or the IM Act and updates the reference to the Commission's rules of practice and procedure.

R14-4-302. Definitions: deletes superfluous definitions already contained in the Securities Act and the IM Act and adds definitions to be used in the Enforcement rules, as amended.

R14-4-303. Confidentiality: provides for confidentiality of information obtained during an investigation or examination except under limited circumstances and combines the substance of R14-4-117 and original R14-4-303 into one rule.

R14-4-304. Methods of Service of Subpoenas, Notices, Orders, and Other Administrative Documents: extends the scope of the rule to include subpoenas, notices, and orders issued under the IM Act and any other administrative documents filed in an administrative proceeding under the Securities Act or the IM Act; modifies the provisions relating to service completion including a provision deeming service of an order, after initial service has been made, to be complete upon mailing to respondent's last known address; provides methods of service in foreign countries; adds a provision for service on a respondent's attorney; clarifies how various types of entities may be served; and makes certain technical clarifications.

R14-4-305. Rights of Witnesses; Formal Interviews; Procedures: creates a rule violation when a witness in a formal interview knowingly makes a material misstatement or omission and clarifies that the rule applies to both examinations and investigations conducted under the Securities Act or the IM Act.

R14-4-306. Notice of an Opportunity for a Hearing and Notice of a Hearing: extends the applicability of the rule to include notices issued under the IM Act; clarifies methods available to serve notices of an opportunity for a hearing and notices of a hearing; and states

Arizona Administrative Register
Notices of Proposed Rulemaking

that hearings must be held within a specified time unless otherwise provided by law, stipulated by the parties, or ordered by the Commission.

R14-4-307. Temporary cease-and-desist orders: makes technical changes to the rule and clarifies who may appropriately serve a temporary cease-and-desist order.

R14-4-308. Rescission and Restitution: extends the scope of the rule to apply to rescission and restitution ordered under the IM Act; clarifies certain rule provisions; and provides the Commission more flexibility in issuing rescission and restitution orders in order to promote the public interest.

R14-4-117. Non-disclosure of information obtained in the course of examinations and investigations: repeals this rule as duplicative and obsolete in light of proposed amendment to R14-4-303.

5. A showing of good cause why the rule is necessary to promote a statewide interest if the rule will diminish a previous grant of authority of a political subdivision of this state:

Not applicable.

6. The preliminary summary of the economic, small business and consumer impact:

The proposed amendments to the Enforcement rules and the repeal of R14-4-117 should not impose additional costs on businesses in the securities industry. In fact, the amendments may reduce costs by producing more efficient administrative proceedings. For the investment advisory industry, the same should hold true. Currently, since the Enforcement rules do not technically apply to the IM Act, the rights and obligations of an investment adviser or investment adviser representative subject to an investigation or enforcement action may be somewhat unclear. Thus adoption of the proposed amendments and repeal should clarify these rights and obligations and resolve any ambiguities. This should be especially helpful to businesses which might not be familiar with administrative proceedings. Additionally, the new flexibility provided for rescission and restitution under the proposed amendment to R14-4-308 should benefit consumers, the securities industry, and the investment advisory industry by allowing for greater flexibility in resolving disputed matters.

The proposed amendments make no distinction for small businesses. However, the proposed amendments have the benefit of clarifying the rights and obligations of such a business when involved in an investigation or enforcement proceeding. Thus, the proposed amendments should be beneficial to small businesses.

Consumers are expected to benefit from the proposed amendments to the Enforcement rules and the repeal of R14-4-117 as the amendments will subject investment advisers and their representatives to the enforcement rules. Also, this will provide the Commission with more regulatory tools with which to combat fraudulent activity and should result in a reduction in the incidence of fraud in the securities and investment advisory industries.

7. The name and address of agency personnel with whom persons may communicate regarding the accuracy of the economic, small business, and consumer impact statement:

Name: Richard Weinroth, General Counsel
Address: Arizona Corporation Commission, Securities Division
1300 West Washington, Third Floor
Phoenix, Arizona 85007
Phone: (602) 542-4242
Fax: (602) 542-3583

8. The time, place, and nature of the proceedings for the adoption, amendment, or repeal of the rule or, if no proceeding is scheduled, where, when, and how persons may request an oral proceeding on the proposed rule:

Date: October 19, 1995
Time: 9 a.m.
Location: Arizona Corporation Commission
1200 West Washington Avenue
Phoenix, Arizona 85007
Nature: Oral Proceeding

Close of Record: Open meeting of the Arizona Corporation Commission at which the Commission will consider the hearing officer's recommended order with respect to the rule.

9. Any other matters prescribed by statute that are applicable to the specific agency or to any specific rule or class of rules:
None.

10. Incorporations by reference and their location in the rules:

The Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents, Nov. 15, 1965, 20 U.S.T. 361, appears in R14-4-304(E)(1). The Hague Convention is available from the Treaty Affairs Section, Office of the Legal Adviser, Department of State, Washington, D.C. 20520.

11. The full text of the rules follows:

**TITLE 14. PUBLIC SERVICE CORPORATIONS; CORPORATIONS AND
ASSOCIATIONS; SECURITIES REGULATION**

**CHAPTER 4. CORPORATION COMMISSION
SECURITIES**

Arizona Administrative Register
Notices of Proposed Rulemaking

**ARTICLE 1. IN GENERAL RELATING TO THE
ARIZONA SECURITIES ACT**

R14-4-117. ~~Non-disclosure of information obtained in the course of examinations and investigations~~

ARTICLE 3. RELATING TO ENFORCEMENT

- R14-4-301. Scope of Article
- R14-4-302. Definitions
- R14-4-303. Confidentiality
- R14-4-304. Methods of Service of Subpoenas, Notices, Orders, and Other Administrative Documents
- R14-4-305. Rights of Witnesses; Formal Interviews; Procedures
- R14-4-306. Notice of an Opportunity for a Hearing and Notice of a Hearing
- R14-4-307. Temporary cease-and-desist orders
- R14-4-308. Rescission and Restitution

**ARTICLE 1. IN GENERAL RELATING TO THE
ARIZONA SECURITIES ACT**

~~R14-4-117. Non-disclosure of information obtained in the course of examinations and investigations~~

~~Information or documents obtained by officers, by employees of the securities division in the course of any examination or investigation shall, unless made a matter of public record, be deemed confidential. Officers and employees are hereby prohibited from making such confidential information available to anyone other than a member of the Commission, officer or employee, unless the Commission or the Director of Securities authorized the disclosure of such information or the production of such documents as not being contrary to the public interest.~~

ARTICLE 3. RELATING TO ENFORCEMENT

R14-4-301. Scope of Article

This Article applies only to investigations and examinations conducted pursuant to the provisions of the Securities Act and the IM Act, and to any orders issued under such acts, A.R.S. §§ 44-1822 and 44-1823 and cease and desist orders issued pursuant to A.R.S. § 44-2032. When not in conflict with this Article, the applicable provisions of R14-3-101 through R14-3-112 R14-3-113 also shall also apply.

R14-4-302. Definitions

The following definitions shall apply to this Article 3 for the purposes of the rule unless the context otherwise requires:

1. "Attorney General" means the duly qualified and acting Attorney General of Arizona or his duly appointed assistant.
2. "Commission" means the Arizona Corporation Commission.
3. "Director" means the Director of the Securities Division of the Arizona Corporation Commission or a person delegated by the Director to act on his behalf.
- 4.2. "Division" means the Securities Division of the Arizona Corporation Commission.
53. "Formal interview" means the examination under oath of an individual compelled or requested to testify as part of an investigation or examination under this Article.
4. "IM Act" means the Arizona Investment Management Act, A.R.S. § 44-3101 et seq.
6. "Person" means an individual, corporation, partnership, association, joint stock company, trust, or any other unincorporated organization.

75. "Respondent" means any person who has been captioned in or served a notice or order of the Commission.

6. "Securities Act" means the Securities Act of Arizona, A.R.S. § 44-1801 et seq.

7. "Unincorporated organization" includes a limited liability company for purposes of the definition of "person", as defined in A.R.S. § 44-1801(13).

R14-4-303. Confidentiality

All information or documents obtained by officers, employees, or agents of the Commission, including, but not limited to, the shorthand reporter or stenographer transcribing the reporter's notes, in the course of any examination or investigation shall, unless made a matter of public record, be deemed confidential. Officers, employees, and agents are prohibited from making such confidential information available to anyone other than a member, officer, or employee of the Commission, agents designated by the Commission or Director, the Attorney General, and law enforcement or regulatory officials, except in accordance with any rule of the Commission or unless the Commission or the Director authorizes the disclosure of such information or documents as not contrary to the public interest the Division during the course of any nonpublic investigation are confidential and shall not be disclosed by anyone, including the certified shorthand reporter or the typist who transcribes the reporter's notes, except as permitted under R14-4-117 to anyone other than members or employees of the Commission, the Attorney General, and law enforcement and regulatory officials.

R14-4-304. Methods of Service of Subpoenas, Notices, Orders, and Other Administrative Documents and cease and desist orders

- A. Subpoenas, notices, and orders issued pursuant to the Securities Act or the IM Act, and any other documents filed in an administrative proceeding under the Securities Act or the IM Act, A.R.S. § 44-1823 and cease and desist orders issued pursuant to A.R.S. § 44-2032 may be served by a sheriff, by his deputy, by an employee of the Commission, or by any other person who is not less than 18 years of age and who is authorized by the Division or the Commission to serve its the Commission's subpoena, notice, order, or other documents filed in the administrative proceeding or cease and desist order.
- B. Subpoenas, notices, orders, and other documents filed in an administrative proceeding cease and desist orders may be served upon a natural person including, but not limited to, a dealer, salesman, investment adviser, or investment adviser representative, as follows:
 1. By personal service.
 2. By leaving a copy at the person's dwelling house, or usual place of abode, with a person of suitable age and discretion, but not less than 16 years of age, then residing therein.
 3. By leaving a copy at the person's usual place of business or employment with an employee, express or implied agent, supervisor, owner, officer, partner, or other similar person of suitable age and discretion but not less than 16 years of age.
 4. By leaving delivering a copy with to an agent authorized by express or implied appointment or by law to receive service of process for the person to whom the subpoena, notice, or order or the cease and desist order is addressed.
 5. By mailing a copy of the subpoena, notice, or order or the cease and desist order in an envelope addressed to the last known home dwelling house or usual place of abode or last known business address, postage prepaid.

Arizona Administrative Register
Notices of Proposed Rulemaking

~~This envelope Subpoenas, notices, and temporary cease-and-desist orders shall be sent postage prepaid, by certified mail, with return receipt requested. The signed return receipt shall constitute proof of service of subpoenas, notices, and temporary cease-and-desist orders but shall not be the exclusive method of proving service. Service of all other orders or other documents filed in the administrative proceeding shall be deemed complete when a copy in an envelope, addressed to the last known dwelling house or usual place of abode or last known business address, is deposited in the United States mail with first class postage prepaid.~~

C. ~~A Subpoena subpoena, notice, order, or other document filed in an administrative proceeding may be served upon or cease-and-desist orders addressed to a corporations corporation, partnerships partnership, trusts trust, limited liability company, association, or and other business entities entity, including but not limited to a dealer or an investment adviser, may be served by as follows:~~

1. ~~By leaving a copy with an employee, of suitable age and discretion, but not less than 16 years of age, at any place of business of the corporation, partnership, trust, limited liability company, association, or other business entity; or~~
2. ~~By leaving upon a copy with any officer or director of a corporation, managing or general partner of a partnership, or trustee of a trust, member of a member-managed limited liability company or manager of a manager-managed limited liability company, or any authorized representative of an association or other business entity; or upon~~
3. ~~By leaving a copy with any agent authorized by express or implied appointment or by law to receive service of process for the entity to whom the subpoena, notice, or order or cease-and-desist order is addressed; or~~
4. ~~byBy mailing a copy to the last known business address, postage prepaid. Subpoenas, notices, and temporary cease-and-desist orders shall be sent postage prepaid, by certified mail, with return receipt requested. The signed return receipt shall constitute proof of service of subpoenas, notices, and temporary cease-and-desist orders but shall not be the exclusive method of proving service. Service of all other orders or other documents filed in the administrative proceeding shall be deemed complete when a copy in an envelope, addressed to the last known business address, is deposited in the United States mail with first class postage prepaid. The copy shall be sent certified mail, return receipt requested. The signed return receipt shall constitute proof of service.~~

D. ~~Subpoenas issued under this Article may be amended at any time and the amended subpoena may be served as provided herein. Unless otherwise ordered by the Commission, when a respondent has been served with a notice or a temporary cease-and-desist order and the respondent is represented by an attorney in the administrative proceeding relating to the notice or the temporary cease-and-desist order, service upon the respondent shall be made by making service upon the attorney. Service upon the attorney shall be deemed complete when a copy of any amended notice, order, or other documents filed in the administrative proceeding, addressed to the last known business address of the attorney, is deposited in the United States mail with first class postage prepaid.~~

E. ~~Unless otherwise provided by law, service may be affected in a foreign country:~~

1. ~~By any internationally agreed means reasonably calculated to give notice, such as those means authorized by the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents, Nov. 15, 1965, 20 U.S.T. 361, which is incorporated herein by reference and on file with the Office of the Secretary of State, provided, however, that if service is not affected within six months from the date on which the assistance of the government of the foreign country was requested pursuant to the applicable treaty or convention, service may be affected as directed by the Commission; or~~
2. ~~If internationally agreed means of service are unavailable, provided that service is reasonably calculated to give notice:~~
 - a. ~~In the manner prescribed by the law of the foreign country for service in that country in an action in any of its courts of general jurisdiction; or~~
 - b. ~~As directed by the foreign authority in response to a letter rogatory or letter of request; or~~
 - c. ~~Unless prohibited by the law of the foreign country, by~~
 - i. ~~Delivery of copies of the subpoena, notice, order, or other document filed in the administrative proceeding to the party to be served personally; or~~
 - ii. ~~Any form of mail requiring a signed receipt, to be addressed and dispatched by the Commission to the party to be served; or~~
 - iii. ~~Diplomatic or consular officers when authorized by the United States Department of State; or~~
 - d. ~~If there is no lawful means by which service can be affected in the foreign country, such means as the Commission shall direct.~~

R14-4-305. Rights of Witnesses; Formal Interview; Procedures

- A. Any person required or requested to appear as a witness in person at a formal interview may be accompanied, represented, and advised by a lawyer legal counsel. The lawyer's role during the formal interview shall be limited to the following activities: right to be accompanied, represented, and advised by counsel means the right for the witness to have a lawyer present with him during the formal interview and to have his lawyer,
1. ~~Giving Give~~ legal advice to the witness such person before, during, and after the formal interview; and
 2. ~~Question Questioning~~ the witness such person briefly at the conclusion of the formal interview for the purpose of clarifying any of the testimony the witness such person has given; and
 3. ~~Making Make~~ summary notes during the formal interview solely for the use of the witness and the lawyer his counsel.
- B. Notwithstanding subsection (A) the following lawyers may not represent witnesses:
1. Any lawyer who has represented another witness who has testified at a formal interview in the examination or investigation,
 2. Any lawyer who has represented another person who is a subject of the examination or investigation,
 3. Any lawyer who may be a material witness in the examination or investigation,
 4. Any lawyer who is a subject of the examination or investigation.

Arizona Administrative Register
Notices of Proposed Rulemaking

C. The Director may permit a lawyer to represent a witness in those situations described in subsections (B)(1) through (B)(4) above upon a showing that such representation should be permitted in the interest of justice and will not obstruct the examination or investigation. If a lawyer is not permitted to represent a witness under this subsection (B), that lawyer's partners or associates of his law firm are also precluded from representing the witness.

C.D. All formal interviews may be recorded by the Division either mechanically or by a certified shorthand reporter employed by the Division. No other recording of the formal interview will be permitted, except summary note taking ~~will be~~ allowed.

D.E. Unless permitted in the discretion of the Division, no witness or ~~lawyer the counsel~~ accompanying any such witness shall be permitted to be present during the formal interview of any other witness testifying in a nonpublic examination or investigation. No person not employed by the Commission or the Attorney General shall be present during a formal interview except that the Division may authorize members of law enforcement ~~and or~~ other state, federal, or self-regulatory agencies to be present during such formal interview.

E.F. The Division may exclude from ~~an a formal~~ interview any person previously permitted to attend the formal interview, including ~~counsel a lawyer~~, whose conduct is dilatory, obstructionist, or contumacious. In addition, the members of the staff of the Division conducting the formal interview may report the conduct to the Director for appropriate action. The Director may thereupon take such further action as the circumstances may warrant, including, but not limited to, exclusion from further participation in the examination or investigation.

F.G. A person who has submitted documentary evidence or testimony in connection with a formal interview shall be entitled, upon written request, and upon proper identification, to inspect the witness' own testimony on a date to be set by the Director. The Director may delay the inspection of the record until the conclusion of the examination or investigation if in his discretion he determines that earlier inspection may obstruct or delay the examination or investigation.

G.H. In connection with an examination or investigation, the Director may delegate authority to members of the staff to administer oaths and affirmations, sign subpoenas, take evidence and receive books, papers, contracts, agreements or other documents, records, or information, whether filed or kept in original or copied form or electronically stored or recorded.

I. During a formal interview, a witness shall not knowingly make any untrue statements of material fact or omit to state any material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

R14-4-306. Notice of an Opportunity for a Hearing and Notice of a Hearing

A. The Commission may issue a notice of an opportunity for a hearing or a notice of a hearing to determine whether to issue a cease-and-desist order, order of rescission, restitution, or penalties, or other order as authorized pursuant to the provisions of A.R.S. § 44-2032(1) the Securities Act or the IM Act.

B. A Notices notice of an opportunity for a hearing and a notice of a hearing shall be served by any method permitted in R14-4-304 sent by personal service or by registered mail, return receipt requested, to the respondent's business address, or the statutory agent of record. The A notice of an

opportunity for a hearing shall set forth that the respondent will be afforded a hearing upon request to ~~docket~~ docket control of the Commission if the request is made in writing within ten days after receipt of the notice by the respondent.

C. When a respondent requests a hearing pursuant to a notice of an opportunity for a hearing in accordance with the provisions of this rule, the Commission shall set a date, time, and place for the hearing and shall forthwith notify the respondent. The date set for the hearing shall be within 30 days, but not earlier than 15 days after the written request for hearing has been made, unless otherwise provided by law, stipulated by the parties, or ordered by the Commission agreed to by both the Commission and the respondent.

R14-4-307. Temporary Cease-and-desist orders

A. When the Division determines that the public interest will be harmed by delay in issuing an order to cease and desist, the Division may, with the consent of the Commission, issue a temporary cease-and-desist order which will be in effect for 120 days or until vacated, modified, or made permanent in accordance with this ~~Rule~~ rule, whichever comes first.

B. The Commission shall serve a temporary Temporary cease-and-desist order orders shall be served pursuant to rule the provisions of R14-4-304.

C. The temporary cease-and-desist order shall set forth that the respondent will be afforded a hearing upon request to docket control of the Commission if the request is filed in writing within 20 days of service of the temporary cease-and-desist order. If a request for a hearing is not filed within 20 days, the Commission may, by written findings of fact and conclusions of law, vacate, modify, or make permanent the temporary cease-and-desist order.

D. When a respondent requests a hearing in accordance with the provisions of this rule, the Commission shall set a date, time, and place for the hearing and shall forthwith notify the respondent. The date set for the hearing shall be within 15 days, but not earlier than five days, after the written request for hearing has been filed, unless otherwise provided by law, stipulated by the parties, or ordered by the Commission agreed to by both the Commission and respondent. The Commission may, after such hearing, by written findings of fact and conclusions of law, vacate, modify, or make permanent the temporary cease-and-desist order.

R14-4-308. Rescission and Restitution

A. Where there has been a securities have been sold in violation of the Securities Act or the IM Act this Chapter, or any rule or order of the Commission, the person(s) responsible for the violation may be required pursuant to the Securities Act or the IM Act A.R.S. § 44-2032(1) to make rescission and/or restitution as provided herein, in the following manner:

1.B Where a rescission offer is ordered by the Commission,

a1. The following materials must be filed with and receive prior approval from the Director before distribution to the purchasers:

ia. A written offer to repurchase stating in reasonable detail the facts out of which liability arose and, in the event of a violation of A.R.S. §§ 44-1991, or 44-1992, or 44-3241, the correct, true, or omitted facts.

ii.b. An offer to repurchase the security shall include an offer of:

i. Cash (or if the Commission determines it is in the public interest, other property) equal to the fair market value of the consideration paid (determined as of the date such payment was

Arizona Administrative Register
Notices of Proposed Rulemaking

- originally paid by the buyer) or such lesser amount as shall be ordered by the Commission (if it determines that it is in the public interest to order such lesser amount); together with
- ii. Such amount or rate of interest as shall be ordered by the Commission on such amount for the period from the date of purchase payment to the date of repayment; less
 - iii. The amount of any principal, interest, or other distributions received on the security for the period from the date of purchase payment to the date of repayment, such interest to be computed at the legal rate, less the amount of any income received on the security.
 - iiic. The offer to repurchase shall be accompanied by a prospectus and other documents making full written disclosure about the financial and business condition of the issuer and the financial and business risks associated with the retention of the securities, and contain any such further information as the Commission may require.
 - ivd. The offer to repurchase shall state that such offer may be accepted by the purchaser at any time within a specified period of not less than 30 days after the date of receipt thereof unless a shorter period of time is ordered by the Commission.
- b.2 The offer and any other materials required to be presented to the purchaser shall be made within a period specified by the Commission.
- e.3 Financial statements prepared in accordance with A.A.C. R14-4-120, A.R.S. § 44-3159, or other appropriate documentation as requested by the Director or the Commission, shall be provided to the Director. The financial statements or documentation shall demonstrate that the person or persons funding the rescission offer has have adequate funds to pay all purchasers of the securities who are eligible may choose to accept the rescission offer; the amount ordered pursuant to together with interest as stated in subparagraph (a), subdivision (ii) above subsection (B)(1)(b) less the amount of any proceeds received directly from the issuer. The funding of the rescission offer may be provided by the seller, issuer, or other third party.
- d.4 The Commission may order that funds be deposited in escrow as the Commission deems necessary.
- e.5 When the rescission offer has been completed and the appropriate funds paid, the person funding the rescission offer must verify to the Director that the rescission offer was made in accordance with this rule. The verification may be performed by an independent third party, such as an accountant or escrow agent, and by providing the pertinent records documenting the rescission offer to the Director. The following information must be included unless otherwise ordered by the Commission:
- i.a Names, addresses, and telephone numbers and amount of securities held by all such securities holders of the issuer who has had a right to receive the rescission offer, the amount and purchase dates of securities held by such securities holders, and the amount of principal, interest, or other distributions on all securities held by such securities holders;
 - ii.b Names, addresses, and telephone numbers and amount of securities held by all such securities holders of the issuer who did not receive the rescission offer and the reason why they did not receive the rescission offer, the amount and purchase dates of securities held by such securities holders, and the amount of principal, interest, or other distributions on all securities held by such securities holders;
 - iiic Verification of receipt of the rescission offer by all securities holders who had a right to and did receive the rescission offer;
 - ivd. A list of securities holders who accepted the rescission offer and those who did not accept;
 - v.e Verification of full payment of principal together with and interest ordered to be paid to all such securities holders who accepted the rescission offer.
- 2.C. Where restitution is ordered by the Commission,
- a.1. The amount payable as damages to each purchaser shall include the amount computed under paragraph (1), subparagraph (a), subdivision (ii) of this rule, subsection (B)(1)(b) less the amount of any income sale proceeds received on disposal of the security if it was sold at any time by the purchaser.
 - b.2. Financial statements prepared in accordance with R14-4-120, A.R.S. § 44-3159, or other appropriate documentation as requested by the Director or the Commission, shall be provided to the Director. The financial statements or documentation shall demonstrate that the person paying restitution has adequate funds to pay all purchasers the amount computed in paragraph (2), subparagraph (a), subsection (C)(1) of this rule.
 - e.3. The Commission may order that funds be deposited in escrow as the Commission deems necessary.
 - d.4. The Commission may order the respondent to provide the following information to the division Division:
 - i.a. Names, addresses, and telephone numbers of all securities purchasers of such who had a right to receive restitution under the Commission's order; amount and purchase dates of securities purchased by such purchasers; fair market value and dates of the any non-cash consideration received by respondent from each purchaser of such securities; and any payment of income principal, interest, or any other distribution on such security.
 - ii.b. Verification of full payment of principal together with and interest ordered to be paid to all such purchasers.

NOTICE OF PROPOSED RULEMAKING

TITLE 14. PUBLIC SERVICE CORPORATIONS; CORPORATIONS AND ASSOCIATIONS; SECURITIES REGULATION

CHAPTER 6. CORPORATION COMMISSION INVESTMENT MANAGEMENT

PREAMBLE

1. Sections Affected

Article 1
R14-6-101
R14-6-102
R14-6-103
R14-6-104
Article 2
R14-6-201
R14-6-202
R14-6-203
R14-6-204
R14-6-205
R14-6-206
R14-6-207
R14-6-208
R14-6-209

Rulemaking Action

New Article
New Section
New Section
New Section
New Section
New Article
New Section
New Section
New Section
New Section
New Section
New Section
New Section
New Section
New Section

2. The specific authority for the rulemaking, including both the authorizing statute (general) and the statutes the rules are implementing (specific):

Authorizing statute: A.R.S. § 44-3131

Implementing statute: A.R.S. §§ 44-1801, 44-3101, 44-3132, 44-3133, 44-3153, 44-3156, 44-3201, 44-3212, 44-3213, 44-3241, 44-3292, and 44-3296

Constitutional authority: Arizona Constitution Article 15, §§ 4, 6, and 13.

3. The name and address of agency personnel with whom persons may communicate regarding the rulemaking:

Name: Richard Weinroth, General Counsel
Address: Arizona Corporation Commission, Securities Division
1300 West Washington, Third Floor
Phoenix, Arizona 85007
Phone: (602) 542-4242
Fax: (602) 542-3583

4. An explanation of the rule, including the agency's reasons for initiating the rule:

R14-6-101 through R14-6-209 (the "Investment Adviser rules") propose a system of regulation which, combined with the amendments to the enforcement rules (R14-4-301 through R14-4-308, the "Enforcement rules") under the Arizona Securities Act, A.R.S. § 44-1801 *et seq.*, provides a comprehensive framework of regulation as authorized by the Arizona Investment Management Act (the "Act") adopted in April 1994. The Act authorized the Arizona Corporation Commission (the "Commission") to adopt rules reasonably necessary to carry out the purposes of the Act. The Commission is proposing these rules to accomplish that goal. The proposed rules are as follows:

R14-6-101. Scope of rules: states the legal authority for the rules, provides for the waiver of strict adherence to a rule, and provides that the Commission's rules of Practice and Procedure apply when not in conflict with the proposed rules.

R14-6-102. Severability: establishes the severability of the rules and the provisions thereof in case any rule or portion thereof is deemed to be invalid.

R14-6-103. Definitions: defines various terms used throughout the rules.

R14-6-104. Enforcement of the Arizona Investment Management Act: provides that the rules relating to enforcement matters will be contained in the Enforcement rules which are being amended to pertain to investment advisers.

R14-6-201. Books and Records of Investment Advisers: requires investment advisers to comply with the Securities and Exchange Commission's ("SEC") books and records rule; also requires the maintenance of certain additional records in separate files.

R14-6-202. Supervision: provides a safe harbor for investment advisers with respect to their supervisory responsibilities by setting forth procedures that investment advisers can follow to reduce their potential liability for failure to adequately supervise.

R14-6-203. Dishonest and Unethical Practices: provides guidance as to which investment adviser and investment adviser representative practices will be construed to fall within the term "dishonest or unethical" for purposes of A.R.S. § 44-3201(A)(13).

R14-6-204. Written Examination: requires each investment adviser who is a sole proprietor and each investment adviser representative to score at least 70% on the Series 65 or Series 66 examination and to either complete and maintain one of the industry credentials listed in the rule or score at least 70% on the Series 7 or Series 2 examination.

Arizona Administrative Register
Notices of Proposed Rulemaking

R14-6-205. Information to be Furnished to Clients: requires compliance with the SEC's brochure rule and requires that the investment adviser disclose to the client, in writing, the availability of Part I of the Form ADV.

R14-6-206. Custody of Client Funds or Securities by Investment Advisers: makes it a fraudulent practice under the Act for an investment adviser to fail to comply with the procedures outlined in the rule when maintaining custody of a client's funds or securities.

R14-6-207. Suitability of Investment Advisory Services: makes it a fraudulent practice under the Act for an investment adviser to fail to provide investment advice consistent with the client's financial situation, investment experience, and investment objectives.

R14-6-208. Advertisements by Investment Advisers or Investment Adviser Representatives: makes it a fraudulent practice under the Act for an investment adviser or investment adviser representative to fail to comply with the limitations on advertising and the requirements outlined in the rule.

R14-6-209. Financial and Disciplinary Information that Investment Advisers Must Disclose to Clients: makes it a fraudulent practice for an investment adviser to fail to disclose to any client or prospective client all material facts with respect to (1) a financial condition that may affect the adviser's ability to meet contractual commitments to clients where the adviser has discretionary authority, custody, or requires prepayments of fees, or (2) a legal or disciplinary event that is material to the evaluation of the adviser's integrity or ability to meet contractual commitments to clients.

5. **A showing of good cause why the rule is necessary to promote a statewide interest if the rule will diminish a previous grant of authority of a political subdivision of this state:**

Not applicable.

6. **The preliminary summary of the economic, small business and consumer impact:**

The Investment Adviser rules will affect investment advisers and investment adviser representatives that are subject to the Act. In accordance with the intent of the Act, the Investment Adviser rules set standards of qualification and practice for investment advisers and their representatives. It appears that the compliance efforts required by the Investment Adviser rules will create some costs for investment advisers and their representatives. For investment advisers that are registered federally or in other states, these costs should be marginal, as those advisers are already complying with substantially similar regulations federally and in other states. For advisers that are not registered elsewhere and will only be subject to regulation in Arizona, the costs may be greater as they will now be required to undertake certain examination requirements and compliance efforts.

The Investment Adviser rules make no distinction for small investment advisory businesses as it was the intent of the Act to regulate investment advisers doing business in Arizona, particularly those that are not subject to regulation federally or by other states.

The Investment Adviser rules should benefit consumers as they will provide minimum thresholds of expertise for an investment adviser or investment adviser representative to become licensed. Further, the Investment Adviser rules require advisers to comply with various disclosure requirements and standards of practice. This should allow consumers to better compare and evaluate an adviser's qualifications and services. Lastly, the Investment Adviser rules should assist the Commission in combating investment advisory fraud in the state, which will be a great benefit to consumers.

7. **The name and address of agency personnel with whom persons may communicate regarding the accuracy of the economic, small business, and consumer impact statement:**

Name: Richard Weinroth, General Counsel
Address: Arizona Corporation Commission, Securities Division
1300 West Washington, Third Floor
Phoenix, Arizona 85007
Phone: (602) 542-4242
Fax: (602) 542-3583

8. **The time, place, and nature of the proceedings for the adoption, amendment, or repeal of the rule or, if no proceeding is scheduled, where, when, and how persons may request an oral proceeding on the proposed rule:**

Date: October 18, 1995

Time: 9 a.m.

Location: Arizona Corporation Commission
1200 West Washington Avenue
Phoenix, Arizona 85007

Nature: Oral Proceeding

Close of Record: Open meeting of the Arizona Corporation Commission at which the Commission considers the hearing officer's recommended order with respect to the rule.

9. **Any other matters prescribed by statute that are applicable to the specific agency or to any specific rule or class of rules:**

None.

10. **Incorporations by reference and their location in the rules:**

Form ADV, the Uniform Application for Investment Adviser Registration [17 CFR 279.1 (1994) (Form amended at 59 FR 21657 (1994) and 59 FR 27659 (1994)] is located in R14-6-103(B)(7), R14-6-203(15), R14-6-205(B), and R14-6-206(1). Securities and Exchange Commission Rule 204-2 (17 CFR 275.204-2 (1994)) is located in R14-6-201(A) and (C). Securities and Exchange Commission Rule 204-3 [59 FR 21661 (1994) (to be codified at 17 CFR 275.204-3)] is located in R14-6-205 (A) and (C). Commodity Exchange Act (7 U.S.C. 1 *et seq.* (1988 & Supp. V 1993)) is located in R14-6-209(A)(1). The Federal Register (FR) and the Code of Federal Regulations (CFR) are published by the Office of the Federal Register, and are available from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402. The United States Code (U.S.C.) is published by and available from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.

11. **The full text of the rules follows:**

Arizona Administrative Register
Notices of Proposed Rulemaking

**TITLE 14. PUBLIC SERVICE CORPORATIONS; CORPORATIONS AND
ASSOCIATIONS; SECURITIES REGULATION**

**CHAPTER 6. CORPORATION COMMISSION
INVESTMENT MANAGEMENT**

**ARTICLE 1. GENERAL rules RELATING TO THE
ARIZONA INVESTMENT MANAGEMENT ACT**

- R14-6-101 Scope of rules
- R14-6-102 Severability
- R14-6-103 Definitions
- R14-6-104 Enforcement of the Arizona Investment Management Act

**ARTICLE 2. DUTIES OF INVESTMENT ADVISERS AND
INVESTMENT ADVISER REPRESENTATIVES**

- R14-6-201 Books and Records of Investment Advisers
- R14-6-202 Supervision
- R14-6-203 Dishonest and Unethical Practices
- R14-6-204 Written Examination
- R14-6-205 Information to be Furnished to Clients ("Brochure Rule")
- R14-6-206 Custody of Client Funds or Securities by Investment Advisers
- R14-6-207 Suitability of Investment Advisory Services
- R14-6-208 Advertisements by Investment Advisers or Investment Adviser Representatives
- R14-6-209 Financial and Disciplinary Information that Investment Advisers Must Disclose to Clients

**ARTICLE 1. GENERAL rules RELATING TO THE
ARIZONA INVESTMENT MANAGEMENT ACT**

R14-6-101. Scope of rules

The following rules are adopted by the Commission under the authority granted pursuant to Chapter 13. All rules shall be generally applicable to the administration of the IM Act but the Commission or the Director may at any time abrogate or waive strict adherence to any particular rule in any specific instance where the Commission or Director may deem it advisable for the equitable administration of the law. When not in conflict with these rules, the applicable provisions of A.A.C. R14-3-101 through R14-3-113 also shall apply.

R14-6-102. Severability

The provisions of the rules promulgated under Chapter 13 are severable. If any provision of a rule is held to be invalid, such invalidity shall not affect other provisions which can be given effect without the invalid provision.

R14-6-103. Definitions

- A. The definitions set forth in A.R.S. §§ 44-1801 and 44-3101 shall apply to the rules promulgated under Chapter 13.
- B. The following definitions shall apply to all rules promulgated under Chapter 13 unless the context otherwise requires:
 - 1. "IM Act" means the Arizona Investment Management Act, A.R.S. § 44-3101 *et seq.*
 - 2. "Advertisement" includes, but is not limited to, any notice, circular, letter, or other written, oral, or electronically generated communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which directly or indirectly offers:

- a. Any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell; or
 - b. Any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell; or
 - c. Any other investment advisory service with regard to securities.
- 3. "Certified public accountant" or "CPA" means an accountant who has been registered or licensed to practice public accounting and is permitted to use the title "certified public accountant" and use the initials "CPA" after his or her name.
 - 4. "Chapter 13" means A.R.S. Title 44, Chapter 13.
 - 5. "Division" means the Securities Division of the Arizona Corporation Commission.
 - 6. "Fixed-fee basis" means an investment advisory fee which at any given time can be precisely established in dollar amount without regard to the investment performance or value of an account and which is not based on the purchase or sale of specific securities.
 - 7. "Form ADV" means the Uniform Application for Investment Adviser Registration, [17 CFR 279.1 (1994) (Form amended at 59 FR 21657 (1994) and 59 FR 27659 (1994)] which is incorporated by reference and on file in the Office of the Secretary of State. Copies of Form ADV are available from the Division and from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.
 - 8. "Impersonal advisory services" means investment advisory services provided solely:
 - a. By means of written material or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts;
 - b. Through the issuance of statistical information containing no expression of opinion as to the investment merits of a particular security; or
 - c. Any combination of the foregoing services.
 - 9. "NASAA" means the North American Securities Administrators Association, Inc. or any successor organization.
 - 10. "NASD" means the National Association of Securities Dealers, Inc. or any successor organization.
 - 11. "Relative" means any relationship by blood, marriage, or adoption, not more remote than first cousin.
 - 12. "SEC" means United States Securities and Exchange Commission.
 - 13. "Securities Act" means the Securities Act of Arizona, A.R.S. § 44-1801 *et seq.*
 - 14. "Unincorporated organization" includes a limited liability company for purposes of the definition of "person," as defined in A.R.S. § 44-1801(13).

Arizona Administrative Register
Notices of Proposed Rulemaking

R14-6-104. Enforcement of the Arizona Investment Management Act

The rules relating to investigations and examinations conducted pursuant to and orders issued under the IM Act are contained at A.A.C. R14-4-301 through R14-4-308.

ARTICLE 2. DUTIES OF INVESTMENT ADVISERS AND INVESTMENT ADVISER REPRESENTATIVES

R14-6-201. Books and Records of Investment Advisers

- A. Each investment adviser shall make, maintain, and preserve books and records in compliance with SEC Rule 204-2, 17 CFR 275.204-2 (1994) ("Rule 204-2") which is incorporated by reference and on file with the Office of the Secretary of State. The investment adviser shall concurrently file with the Commission a copy of any notices or written undertakings required to be filed with the SEC under Rule 204-2.
- B. To the extent that the SEC amends Rule 204-2, investment advisers in compliance with Rule 204-2 as amended shall not be deemed to be in violation of this rule and shall not be subject to enforcement action by the Commission for violation of this rule to the extent that the violation results solely from the investment adviser's compliance with the amended Rule 204-2.
- C. As of the effective date of this rule, each investment adviser shall make, maintain, and preserve the following additional books and records:
1. A file containing each customer complaint received relating to advisory activities conducted by the investment adviser, its investment advisory representatives, or its employees, and all correspondence relating to such complaint. Such information shall be maintained and preserved for at least five years from the date of receipt;
 2. A file containing all advertisements used by the investment adviser or any investment adviser representative in the previous five years, including any radio or television transcripts and advertisements placed on computer or electronic bulletin boards;
 3. In each client file, all correspondence received or sent by the investment adviser, any investment adviser representative, or any employee, in the previous five years, that relates to any client account, securities, or funds; and
 4. Each client's written acknowledgements obtained pursuant to R14-6-205(B).
- D. Books and records that are required to be maintained pursuant to subsection (A) shall be available for inspection by the Commission in accordance with the provisions of Rule 204-2. Books and records that are required to be maintained pursuant to subsection (B) shall be readily accessible and may be preserved in accordance with Rule 204-2(G).

R14-6-202. Supervision

For purposes of A.R.S. § 44-3201(A)(12), no investment adviser shall be deemed to have failed to reasonably supervise its investment adviser representatives or employees if:

1. There have been established and maintained written procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any violation by such investment adviser representatives or employees of the IM Act, or any rule adopted thereunder; and
2. Such investment adviser has reasonably discharged the duties and obligations incumbent upon it by reason of such procedures and system without reasonable cause to

believe that such procedures and system were not being complied with.

R14-6-203. Dishonest and Unethical Practices

"Dishonest and unethical practices", with respect to investment advisers and investment adviser representatives under A.R.S. § 44-3201(A)(13), shall include, but not be limited to, the following:

1. Refusing to allow or otherwise impeding designees of the Commission from conducting an investigation or examination under the IM Act or any rule adopted thereunder;
2. Placing an order to purchase or sell a security for the account of a client without authority to do so;
3. Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first obtaining a written third-party trading authorization from the client;
4. Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without first obtaining written discretionary authority, unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of specified securities shall be executed, or both;
5. Inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objectives, and character of the account;
6. Borrowing money or securities from a client or client's account unless the client is a dealer, an affiliate, or relative of the investment adviser or investment adviser representative, or a financial institution or other entity engaged in the business of loaning funds or securities;
7. Loaning money to a client unless the investment adviser or investment adviser representative is a financial institution or other entity engaged in the business of loaning funds or the client is an affiliate or relative of the investment adviser or investment adviser representative;
8. Misrepresenting to any client, or prospective client, the qualifications of the investment adviser, the investment adviser representative, or an employee, or misrepresenting the nature of the investment advisory services being offered or fees to be charged for such services, or omitting to state a material fact necessary to make the statements made regarding qualifications, services, or fees, in light of the circumstances under which they were made, not misleading;
9. Providing a report or recommendation to any client prepared by someone other than the investment adviser or investment adviser representative without disclosing that fact. This prohibition does not apply to a situation where the investment adviser or investment adviser representative uses published research reports or statistical analyses to render investment advice or where the investment adviser or investment adviser representative orders such a report in the ordinary course of providing service;
10. Charging a client an investment advisory fee that is unreasonable based upon industry standards including, but not limited to, the type of services to be provided and the experience and expertise of the investment adviser and the investment adviser representative;
11. Failing to disclose to a client in writing before entering into or renewing an investment advisory agreement with that client, or before any investment advice is rendered, any material conflict of interest relating to the invest-

Arizona Administrative Register
Notices of Proposed Rulemaking

ment adviser, the investment adviser representative, or an employee which could reasonably be expected to impair the rendering of unbiased and objective advice including, but not limited to:

- a. Compensation arrangements connected with investment advisory services to clients which are in addition to compensation from such clients for those services;
 - b. Charging a client an investment advisory fee for rendering investment advice without disclosing that compensation for executing securities transactions pursuant to such investment advice will be received by the investment adviser, the investment adviser representative, or an employee; and
 - c. Undisclosed, conflicting securities positions;
12. Promising or guaranteeing a client that a gain, loss, or other outcome will be achieved as a result of the investment advice;
13. Disclosing the identity, affairs, or investments of a client to any third party unless required by law to do so, or unless consented to by the client;
14. With respect to any client initially retained after the effective date of this rule, entering into, extending, modifying, or renewing any investment advisory contract unless such contract is in writing and discloses all the material terms of the contract including but not limited to the services to be provided, the investment advisory fee or the formula for computing the fee, the amount or the manner of calculation of the amount of the prepaid fee to be returned in the event of contract termination or non-performance, and of any grant of discretionary power to the investment adviser;
15. With respect to any client initially retained after the effective date of this rule, entering into, extending, modifying, or renewing any investment advisory contract without disclosing, in writing to the client, all disciplinary questions affirmatively answered in Part I of Form ADV, and the answers thereto;
16. Entering into, extending, modifying, or renewing any investment advisory contract which allows the assignment of such contract by the investment adviser without the prior written consent of the client;
17. Committing any act that results in denial, revocation, or suspension of a license or registration relating to securities by an agency of any state, where such denial, revocation, or suspension arises out of any scheme, act, practice, or course of business that operates or would operate as a fraud or deceit, or arises out of a violation of Article 13 of the Securities Act or the rules promulgated thereunder;
18. For any investment adviser who has discretionary authority over a client's account, failing to provide or cause to be provided to the client an itemized account statement on both an annual and a quarterly basis indicating:
- a. All transactions during the account period, including any fee deductions; and
 - b. The funds, securities, and other property in the account at the end of the account period and the total change in value in the account since the end of the previous account period;
19. For an investment adviser who charges clients investment advisory fees other than on an hourly or a fixed-fee basis, failing to provide or cause to be provided to the client an itemized statement on at least an annual basis,

indicating the total fees and commissions earned by the investment adviser on such client's account during the period of time since the previous statement;

20. For any investment adviser to, in any manner, request or require, in any contract, agreement, or otherwise, any condition, stipulation, or provision binding on any person to waive compliance with any provision of the IM Act or the rules thereunder. Any such waiver shall be void.

R14-6-204. Written Examination

- A. Prior to licensure, except as provided in subsection (B), each investment adviser who is an individual and each investment adviser representative, each of whom is hereafter referred to as an "applicant," must take and receive a score of at least 70% on:
1. The NASAA Series 65 Uniform Investment Adviser State Law Examination or Series 66 Combined State Law Examination, and
 2. The NASD Series 7 General Securities Registered Representative Examination or Series 2 General Securities Representative (Non-Member) Examination.
- B. The examinations described in subsection (A)(2) shall not be required of an applicant who has completed and maintains one of the following credentials:
1. Certified Financial Planner (CFP) designation awarded by the Certified Financial Planner Board of Standards, Inc.;
 2. Chartered Financial Analyst (CFA) designation awarded by the Institute of Chartered Financial Analysts;
 3. Chartered Financial Consultant (ChFC) designation awarded by the American College, Bryn Mawr, Pennsylvania;
 4. Chartered Investment Counselor (CIC) designation awarded by the Investment Counsel Association of America, Inc.; or
 5. Personal Financial Specialist (PFS) designation awarded by the American Institute of Certified Public Accountants.
- C. In the event that the NASAA or NASD Series examination numbers change, the most current examination series deemed applicable by the Director to the category of licensure shall apply.
- D. In the event that the title changes for any of the credentials designated in subsection (B), the title deemed applicable by the Director shall apply.

R14-6-205. Information to be Furnished to Clients ("Brochure Rule")

- A. Each investment adviser shall comply with the provisions of SEC Rule 204-3, [59 FR 21661 (1994) (to be codified at 17 CFR 275.204-3)] ("Rule 204-3"), which is incorporated by reference and on file with the Office of the Secretary of State.
- B. With respect to any client initially retained after the effective date of this rule, each investment adviser shall disclose in writing to each client the availability upon request of Part I of Form ADV and the nature of the information provided therein. The investment adviser shall retain in each client file a client statement acknowledging receipt of the disclosure.

Note: Compliance with subsection (B) does not fulfill an investment adviser's obligation under R14-6-203(15), except where an investment adviser has no affirmative answers to the disciplinary questions in Part I of the Form ADV.

C. To the extent that the SEC amends Rule 204-3, investment advisers in compliance with Rule 204-3 as amended shall not be deemed to be in violation of this rule and shall not be subject to enforcement action by the Commission for violation of this rule to the extent that the violation results solely from the investment adviser's compliance with the amended Rule 204-3.

R14-6-206. Custody of Client Funds or Securities by Investment Advisers

It shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any investment adviser to take or have custody of any securities or funds of any client unless:

1. The investment adviser notifies the Commission in writing that the investment adviser has or may have custody of client funds or securities. Such notification may be given on Form ADV;
2. The securities of each client are segregated, marked to identify the particular client having the beneficial interest therein, and held in safekeeping in some place reasonably free from risk of destruction or other loss;
3. All client funds are deposited in one or more bank or similar accounts containing only clients' funds, such accounts are maintained in the name of the investment adviser as agent or trustee for such clients, and the investment adviser maintains a separate record for each such account showing the name and address of the bank or similar institution where the account is maintained, the dates and amounts of deposits into and withdrawals from the account, and the exact amount of each client's beneficial interest in the account;
4. Immediately after accepting custody or possession of funds or securities from any client, the investment adviser notifies the client in writing of the place where and the manner in which the funds and securities will be maintained and, subsequently, if and when there is a change in the place where or the manner in which the funds or securities are maintained, the investment adviser gives prompt (but in no event more than five business days) written notice thereof to the client;
5. At least once every three months, the investment adviser sends each client an itemized statement showing the client's funds and securities in the investment adviser's custody at the end of such period and all debits, credits and transactions in the client's account during such period; and
6. At least once every calendar year, an independent CPA verifies all client funds and securities by actual examination at a time chosen by the independent CPA without prior notice to the investment adviser. The independent CPA's report stating that such CPA has made an examination of such funds and securities, and describing the nature and extent of the examination, shall be filed with the Commission promptly (but in no event more than 30 days) after each such examination.

R14-6-207. Suitability of Investment Advisory Services

It shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any person providing investment advisory services to provide investment advisory services to any client, other than in connection with impersonal advisory services, unless the person:

1. Before providing any investment advisory services, and as appropriate thereafter, makes a reasonable inquiry of the client as to the financial situation, investment experience, and investment objectives of the client; and

2. Reasonably determines that the investment advisory services are suitable for the client based upon the information obtained from the client in accordance with subsection (1) above.

R14-6-208. Advertisements by Investment Advisers or Investment Adviser Representatives

A. It shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any investment adviser or investment adviser representative, directly or indirectly, to use any advertisement:

1. Which refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or investment adviser representative or concerning any advice, analysis, report, or other service rendered by such investment adviser; or
2. Which refers, directly or indirectly, to past specific recommendations of such investment adviser or investment adviser representative which were or would have been profitable to any person; provided, however, that this shall not prohibit an advertisement which sets out or offers to furnish a list of all recommendations made by such investment adviser or investment adviser representative within the immediately preceding period of not less than one year if such advertisement, and such list if it is furnished separately:
 - a. States the name of each such security recommended, the date and nature of each such recommendation (e.g., whether to buy, sell or hold), the market price at that time, the price at which the recommendation was to be acted upon, and the market price of each such security as of the most recent practicable date; and
 - b. Contains the following cautionary legend on the first page thereof in print or type as large as the largest print or type used in the body or text thereof: "It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list;" or
3. Which represents, directly or indirectly, that any graph, chart, formula, or other device being offered can in and of itself be used to determine which securities to buy or sell, or when to buy or sell them; or which represents, directly or indirectly, that any graph, chart, formula, or other device being offered will assist any person in making his own decisions as to which securities to buy or sell, or when to buy or sell them, without prominently disclosing in such advertisement the limitations thereof and the difficulties with respect to its use; or
4. Which contains any statement to the effect that any report, analysis, or other service will be furnished free or without charge, unless such report, analysis, or other service actually is or will be furnished entirely free and without any condition or obligation, directly or indirectly; or
5. Which states that the Commission has approved any advertisement.

B. When requested by the Commission, any advertisement used directly or indirectly in connection with the provision of investment advisory services shall be filed with the Commission at least ten business days prior to its proposed use.

C. Any advertisement that has been requested by the Commission pursuant to the provisions of subsection (B) of this Section but that has not been filed with the Commission shall not be used.

Arizona Administrative Register
Notices of Proposed Rulemaking

R14-6-209. Financial and Disciplinary Information that Investment Advisers Must Disclose to Clients

A. The following definitions shall apply to this Section:

1. "Investment-related" means pertaining to securities, commodities, banking, insurance, or real estate (including, but not limited to, acting as or being associated with a broker-dealer, investment company, investment adviser, government securities broker or dealer, municipal securities dealer, bank, savings and loan association, entity, or person required to be registered under the Commodity Exchange Act (7 U.S.C. 1 *et seq.* (1988 & Supp. V 1993) which is incorporated by reference and on file with the Secretary of State's Office), or fiduciary).
2. "Involved" means acting or aiding, abetting, causing, counseling, commanding, inducing, conspiring with, or failing reasonably to supervise another in doing an act.
3. "Management person" means a person with power to exercise, directly or indirectly, a controlling influence over the management or policies of an investment adviser which is a company or to determine the general investment advice given to clients.
4. "Self-Regulatory Organization" or "SRO" means any national securities or commodities exchange, registered association, or registered clearing agency.

B. It shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any investment adviser to fail to disclose to any client or prospective client all material facts with respect to:

1. A financial condition of the investment adviser that is reasonably likely to impair the ability of the investment adviser to meet contractual commitments to clients, if the investment adviser has discretionary authority (express or implied) or custody over such client's funds or securities, or requires prepayment of advisory fees of more than \$500 from such client, six months or more in advance; or
2. A legal or disciplinary event that is material to an evaluation of the investment adviser's integrity or ability to meet contractual commitments to clients.

C. It shall constitute a rebuttable presumption that the following legal or disciplinary events involving the investment adviser or a management person of the investment adviser (any of the foregoing being referred to hereafter as a "person") that were not resolved in the person's favor or subsequently reversed, suspended, or vacated are material within the meaning of subsection (B)(2) of this Section for a period of ten years from the time of the event. No affirmative or negative presumption of materiality shall be created under subsection (B)(2) for events not specifically set forth in this subsection.

1. A criminal or civil action in a court of competent jurisdiction in which the person:
 - a. Was convicted, pleaded guilty or nolo contendere ("no contest") to a felony or misdemeanor, or is the named subject of a pending criminal proceeding (any of the foregoing referred to hereafter as "action"), and such action involved: an investment-related business; fraud, false statements, or omissions; wrongful taking of property; or bribery, forgery, counterfeiting, or extortion;

- b. Was found to have been involved in a violation of an investment-related statute, rule, or regulation; or
 - c. Was the subject of any order, judgment, or decree permanently or temporarily enjoining the person from, or otherwise limiting the person from, engaging in any investment-related activity.

2. Administrative proceeding before the Securities and Exchange Commission, the Commission, or any federal regulatory agency or any state agency (any of the foregoing being referred to hereafter as "agency") in which the person:

- a. Was found to have caused an investment-related business to lose its authorization to do business; or
 - b. Was found to have been involved in a violation of an investment-related statute, rule, or regulation and was the subject of an order by the agency denying, suspending, or revoking the authorization of the person to act in, or barring or suspending the person's association with, an investment-related business; or otherwise significantly limiting the person's investment-related activities.

3. Self-Regulatory Organization ("SRO") proceedings in which the person:

- a. Was found to have caused an investment-related business to lose its authorization to do business; or
 - b. Was found to have been involved in a violation of the SRO's rules and was the subject of an order by the SRO barring or suspending the person from membership or from association with other members, or expelling the person from membership; fining the person more than \$2,500; or otherwise significantly limiting the person's investment-related activities.

D. The information required to be disclosed by subsection (B) shall be disclosed to clients promptly but in no event later than 30 days after the occurrence of the event requiring disclosure, and to prospective clients not less than 48 hours prior to entering into any written or oral investment advisory contract, or no later than the time of entering into such contract if the client has the right to terminate the contract without penalty within five business days after entering into the contract.

E. For purposes of calculating the ten-year period during which events are presumed to be material under subsection (C), the date of the reportable event shall be the date on which the final order, judgment, or decree was entered, or the date on which any rights of appeal from preliminary orders, judgments, or decrees lapsed.

F. Compliance with subsection (C) of this rule shall not relieve any investment adviser from the disclosure obligations of subsection (B) of the rule; compliance with subsection (B) of the rule shall not relieve any investment adviser from any other disclosure requirement under the Act, the rules thereunder, or under any other state or federal law.

Note: Investment advisers may disclose this information to clients and prospective clients in their "brochure," the written disclosure statement to clients under R14-6-205, provided, that the delivery of the brochure satisfies the timing of disclosure requirements described in subsection (D) of this rule.